IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 25.10.2006

CORAM

THE HON'BLE MR.JUSTICE P.D.DINAKARAN
AND
THE HON'BLE MR.JUSTICE P.P.S.JANARTHANA RAJA

T.C.(A) No.154 of 2003

Commissioner of Income-tax IV,
Chennai.
.. Appellant

Vs.

A.D.Jayaveerapandia Nadar & Sons,
Chennai. .. Respondent

T.C. Appeal filed against the order of the Income-tax Appellate Tribunal, A-Bench, dated 24.2.2003 made in I.T.A. No.1911(Mds)/98 for the Assessment Year 1993-94 against the Order of the Commissioner of Income Tax [Appeals] VI, Chennai 34 dated 30.7.98 in IT/GT/Appeal No.35/96-97/DC-98/VIII against the order of the Addl. Commissioner of Income Tax, Spl. Range VIII Madras dated 31.1.1996 in GIR.No.300-J/93 PAN/GIR No.47-002 FY-9981

For Appellant : Mr.T.Ravikumar
For Respondent : Mr.J.Balachander

JUDGMENT

(Delivered by P.D.DINAKARAN, J.)

Challenging the order of the Income-tax Appellate Tribunal dated 24.2.2003 made in ITA.No.1911/Mds/98, the Revenue has preferred this appeal raising the following substantial questions of law:

1. Whether in the facts and circumstances of the case, the Tribunal was right in holding that the amounts paid to associate concerns by way of reimbursement of day to day expenses would not be hit by section 40A(3)?

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2. Whether in the facts and circumstances of the case, the conditions under section40A(3) that payments should be made only by crossed cheque or demand draft do not apply to payments made to associate concerns?

2. The brief facts of the case are as follows:

2.1. The respondent/assessee is a partnership firm carrying on the business of export of garments and textiles. The assessee filed a 'nil' return of income for the assessment year 1993-94 on 29.10.1993. The return was processed under section 143(1)(a) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') and an intimation dated 2.3.1994 was sent to the assessee.

2.2. Then, notice under section 143(2) of the Act was issued and a detailed questionnaire dated 30.6.1995 eliciting explanation on various points was also served on the assessee. The assessee appeared for the hearing, and after considering the statement of the assessee relating to cash payments exceeding Rs.10,000/- which frustrated section 40A(3) of the Act, as then existed, the assessing officer held as under:

> "Assessee paid Rs.34,97,760/- as machining charges to ARJ Textiles P.Ltd. U/s.40A(3), expenses paid in excess of Rs.10,000/- in cash is not allowable as explained earlier. The total machining charges amounting to Rs.27,61,100/- have been paid in cash. The explanation given by the assessee is in the case of M/s.ARJ Textiles. The day-to-day expenses like salary payments etc. are to be met out of machining charges payable by the assessee and hence, the amounts are paid in cash by the assessee. The argument of the assessee is not acceptable. U/s.40A(3) total expenditure incurred in violation of provisions of section 40A(3) should be disallowed. However, taking into account the fact that M/s.ARJ Textiles P.Ltd. is accounting the machinery charges received from the assessee and difficulties explained, 20% of the amount of Rs.27,61,100/- is estimated as disallowance u/s.40A(3). The disallowance comes to Rs.5,52,220/-. This included in the income of the assessee."

2.3. Aggrieved by the said 20% disallowance out of total payment of Rs.27,61,100/- paid in cash under section 40A(3) of the Act, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals), who, by order dated 30.7.1998, held as follows:

> "The appellant pleaded that the payment made to the associate concern were only reimbursement expenses incurred and therefore the question of application u/s.40A(3) does not arise. It is not known under what circumstances the above said payment of Rs.27,51,100/- had been made in cash. However, as this concern obviously an associate concern, since the same is excluded from the applicability of sec.40A(3), no addition is called for. The addition made on this account to the extent of

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Rs.5,52,220/- is deleted as the payment refers to the associate concern."

2.4. It appears that the Commissioner was convinced to set aside the disallowance of 20% of total payment paid in cash on the ground that the payments were made to associate concerns for reimbursement of certain expenses incurred by the said associate concerns and section 40A(3) is not therefore attracted.

2.5. Challenging the said reason, the Revenue preferred appeal before the Tribunal contending that section 40A(3) does not contemplate a situation to disallow any part of cash payments, merely for the reason that the payments were made to associate concerns. However, the Tribunal, without going into the legal issues raised by the Revenue, dismissed the appeal and confirmed the order of the Commissioner of Income-tax (Appeals) on the ground that the amount paid by the assessee to the associate concerns was for the purpose of reimbursement of day-to-day expenses and therefore, the claim of the assessee should have been accepted. Hence, this appeal by the Revenue raising the substantial questions of law referred to above.

3. Since we are convinced that both the questions are inter-related and revolves on the point whether cash payments made by the assessee to the associate concerns would attract section 40A(3) of the Act and therefore the said payments are deductible, we propose to deal with both the questions together.

4.1. Before proceeding further, it is apt to refer to section 40A(3), as it then existed, which reads as under:

"Expenses or payments not deductible
in certain circumstances:

40A. (1) xxx

(2) xxx

(3) Where the assessee incurs any expenditure in respect of which payment is made, after such date (not being later than the 31st day of March, 1969) as may be specified in this behalf by the Central Government by notification in the Official Gazette, in a sum exceeding ten thousand rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, such expenditure shall not be allowed as a deduction"

4.2. By virtue of Finance (No.2) Act, 1996 which came into effect from 1.4.1997, the quantum of Rs.10,000/- was increased to Rs.20,000/-.

5. It is also relevant to refer Rule 6DD(j) of Income-tax Rules, 1962 (hereinafter referred to as 'the Rules'), framed in exercise of the powers conferred by section 295 of the Act, which reads thus:

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6DD. No disallowance under sub-section (3) of section 40A shall be made where any payment in a sum exceeding ten thousand rupees is made the cases and circumstances specified hereunder, namely:-

Cases and circumstances in which payment in a sum exceeding ten thousand rupees may be made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft.

(a) to (i) xxx

(j) in any other case, where the assessee satisfied the Assessing officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft -

(1) due to exceptional or unavoidable circumstances, or

(2) because payment in the manner aforesaid was not practicable, or would have caused genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof,

and also furnishes evidence to the satisfaction of the Assessing officer as to the genuineness of the payment and the identity of the payee."

6. The Central Board of Direct Taxes (CBDT) also issued Circular with reference to the interpretation of section 40A(3) of the Act and Rule 6DD (j) of the Rules on 31.5.1977 and Clauses 4 to 6 of the said Circular read as follows:

"4. All the circumstances in which the conditions laid down in rule 6DD(j) would be applicable cannot be spelt out. However, some of them which would seem to meet the requirements of the said rule are:

a. The purchaser is new to the seller; or

b. The translations are made at a place where either the purchase or the seller does not have a bank account; or

c. the transactions and payments are made on a bank holiday; or

d. the seller is refusing to accept the payment by way of crossed cheque/draft and the purchaser's business interest would suffer due to non-availability of goods otherwise than from this particular seller; or

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e. the seller, acting as a commission agent, is required to pay cash in turn to persons from whom he has purchased the goods; or

f. specific discount is given by the seller for payment to be made by way of cash.

5. It can be said that it would, generally, satisfy the requirements of rule 6DD(j), if a letter to the above effect is produced in respect of each transaction falling within the categories listed above from the seller giving full particulars of his address, sales tax number/permanent account number, if any, for the purposes of proper identification to enable the Income-tax Officer to satisfy himself about the genuineness of the transaction. The Income-tax Officer will, however, record his satisfaction before allowing the benefit of rule 6DD(j).

6. It is further clarified that the above circumstances are not exhaustive but illustrative. There could be cases other than those falling within the above categories which would also meet the requirements of rule 6DD(j)."

7. The question relating to the interpretation of the rule 6DD(j) and section 40A(3) came up for consideration before various High Courts and the ratio laid down by the said Courts on the point in issue is as under:-

(i) (a) The object of the provision of section 40A(3) is to check evasion of taxes so that the payment is made from the disclosed sources. Both the payer and the payee would be showing in the respective account the payments made and received. It presupposes that the transactions must be genuine transactions.
(b) The object of the rule is to relax the rigour of sub-section (3) of section 40A in genuine and bona fide cases to avoid hardship and harassment. Practicability for the purpose of rule 6DD(j)(2) must be judged from the point of view of the businessman and not of the Revenue. For the purposes of carrying on his business, a businessman may have to make payment otherwise than by crossed cheque or draft in certain circumstances voluntarily and not out of sheer necessity.
(c) Where the amount was paid in cash or received in cash, the assessing officer has to find out whether the transaction is genuine or not and if he finds that the transaction is genuine, he should allow the deduction. The circular of the Board is not exhaustive; it is only illustrative and the assessing officer has to take into account the surrounding circumstances, considerations of business expediency and the facts of each particular case in exercising his discretion either in favour or against the assessee [vide: Giridharilal v. C.I.T. (Cal) (179 ITR 122)].

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(ii) (a) Genuine and bona fide transactions are not taken out of the sweep of the section and it is open to the assessee to furnish to the satisfaction of the assessing officer, the circumstances under which the payment in the manner prescribed under section 40A(3) was not practicable or would have caused genuine difficulty to the payee.
(b) The Central Board of Direct Taxes has issued certain guidelines giving certain circumstances, and those circumstances are illustrative and not exhaustive and the underlying ideal of the circular is that if the identity of the payee is known, it would be possible for the Income-tax Officer to cross-check whether the transaction had in fact taken place [vide: CIT v. Chrome Leather Co. Pvt. Ltd. (Mad) (235 ITR 708)].

(iii) While considering the exceptional circumstances, the business exigencies, convenience and security should also be looked into. It was a case where neither the genuineness of the payments, nor the identity of the parties was in dispute. If the provisions of rule 6DD (j)(1) were insisted on, the payments would have to be made by depositing the money in the bank by issuing cheques to the payee and the payee would have to draw the amount from the bank. This would have been hazardous and cumbersome procedure.[vide: C.I.T. v. Nikko Auto Ltd. (P & H) (256 ITR 476)].

(iv) Under the provisions of rule 6DD(j) of the Income-tax Rules, 1962, where the assessee satisfies the assessing officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft due to exceptional or unavoidable circumstances or because payment in the manner aforesaid was not practicable, or would have caused genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof and also furnishes evidence to the satisfaction of the assessing officer as to the genuineness of the payment and the identity of the payee, the assessing oauthority has got discretion to allow the expenditure [vide: CIT v. Eastern Condiments Pvt. Ltd. (Ker) (261 ITR 76)].

(v) When the genuineness of the transactions was not doubted or called in question, the amounts could not be disallowed [vide: Ramaditya Investments v. C.I.T.(Delhi) (262 ITR 491)].

(vi) (a) The intention of the Legislature in enacting section 40A(3) particularly was to ensure that payments exceeding the sum specified are made by a crossed cheque drawn on a bank or by a crossed bank draft so that it will be easier to ascertain, when deduction is claimed, whether the payment was genuine and whether it was made out of income from disclosed sources. While interpreting the provisions of this section, the above mischief which was sought to be remedied will have to be borne in mind.
(b) The word, 'practicable' used in rule 6DD(j)(2) must be held to

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signify that which is feasible, that is to say, capable of being put into practice, done, or accomplished with the available means and resources. '

(c) The correct interpretation would be to give to the word 'practicable' a wide and liberal meaning.

(d) In determining the practicability for the purposes of rule 6DD (j)(2), regard will have to be had to the facts and circumstances of each case, for, in the ultimate analysis, it is the actuality which must be the decisive factor and that the taxing authority must approach a case which falls to be decided under rule 6DD(j)(2) in the above light. The practicability for the purposes of rule 6DD(j) (2) must be judged from the point of view of the businessman and not of the Revenue.

(e) The terms of section 40A(3) are not absolute. Considerations of business expediency and other relevant factors are not excluded. Genuine and bona fide transactions are not taken out of the sweep of the section. It is open to the assessee to furnish to the satisfaction of the assessing officer the circumstances under which the payment in the manner prescribed in section 40A(3) was not practicable or would have caused genuine difficulty to the payee. It is also open to the assessee to identify the person who has received the cash payment[vide: CIT v. J.Rajmohan Pillai (Ker) (267 ITR 561)].

(vii) Unless the Tribunal had arrived at a finding of fact that exceptional circumstances existed tow arrant payments in cash or that payment by crossed cheque was not practicable or would have caused genuine difficulty to the payee, the order ought not to have been interfered with by the Tribunal. The consideration which weighed with the Tribunal did not fall within the exceptional or unavoidable circumstances [vide: CIT v. Himachal Terepene Products Pvt. Ltd. (Cal) (269 ITR 538)].

(viii) The requirement under rule 6DD(j) of the Income-tax Rules, 1962, regarding practicability of payment otherwise than in cash and consideration of business expediency has to be judged from the point of view of the businessman and not of the revenue authorities [CIT v. P.Pravin and Co. (Guj) (274 ITR 534)].

8. In the instant case, the assessing officer disallowed 20% of the total amount paid in cash merely on the ground that the payments were made to associate concerns and that the payments were made to meet day-to-day expenses like, salary, etc. and also to meet machining charges. However, the Commissioner of Income-tax (Appeals) deleted even the disallowance of 20% of amount on the ground that the disallowance of 20% is bad, because the payments made to associate concerns were reimbursement expenses and hence, section 40A(3) does not attract, which has been affirmed by the Appellate Tribunal.

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9. In our considered opinion, even though section 40A(3) of the Act is not absolute, payments made in cash cannot automatically be allowed merely for the reason that the payments were made to associate concerns and such reason that weighed the Commissioner of Income-tax (Appeals) is not only illogical, but also outside the scope of section 40A(3) of the Act. If such reason is accepted, the transactions which frustrate section 40A(3) would pave way for evading tax which is contrary to the object of section 40A(3). The cumulative effect of Circular of CBDT dated 31.5.1977, Rule 6DD(j) and section 40A(3) is that the assessee should satisfy that there were exceptional and unavoidable circumstances of transactions in which payments were made in cash and that payment by way of crossed cheque or crossed bank draft was not practicable or the same would have caused genuine difficulty to the payee having regard to the nature of the transaction or there was necessity for expeditious settlement. In addition to that, the assessee should also furnish evidence to the satisfaction of the assessing officer as to the genuineness of payments as well as the identity of payee.

10. In the case on hand, we fail to see that the assessee has satisfactorily explained the exceptional and unavoidable circumstances warranting the payment by cash; the payments by way of crossed cheque or crossed bank draft was not practicable; such payments would have caused genuine difficulties to the payee; and there was necessity for expeditious settlement. Even though it is found that the assessee made cash payments for day-to-day affairs of associate concerns, the reason given by the Commissioner of Income-tax (Appeals) for deleting 20% disallowance that the payments were made to associate concerns and hence, they were allowable cannot be a justifiable reason as it is outside the scope of section 40A(3) of the Act. We are satisfied that the deletion of disallowance of 20% the total amount frustrates section 40A(3) of the Act.

In the result, we answer the questions of law referred to above in favour of the Revenue and against the assessee. The appeal stands allowed. No costs.

Sd/-
Asst. Registrar.

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Sub Asst. Registrar.

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To
1.The Assistant Registrar,
Income Tax Appellate Tribunal
Madras Bench "D" Rajaji Bhavan,
III Floor, Besant Nagar, Chennai 90.

2.The Commissioner of Income-
Tax (Appeals-VI), Chennai 34.

3.The Addl.Commissioner of 1st Spl.R.VIII,
Madras.

4. The Commissioner of Income Tax IV,
Chennai.

+ 1 CC To Mr.Pushya Sitaraman, Advocate SR NO. 50140

+ 1 CC To Mr.J.Balachander, Advocate SR NO.49999

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